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IN THE

Supreme Court of the United States

October Term, 1942.

No. 502

PHILADELPHIA COKE COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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October, 1942.

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CONTENTS.

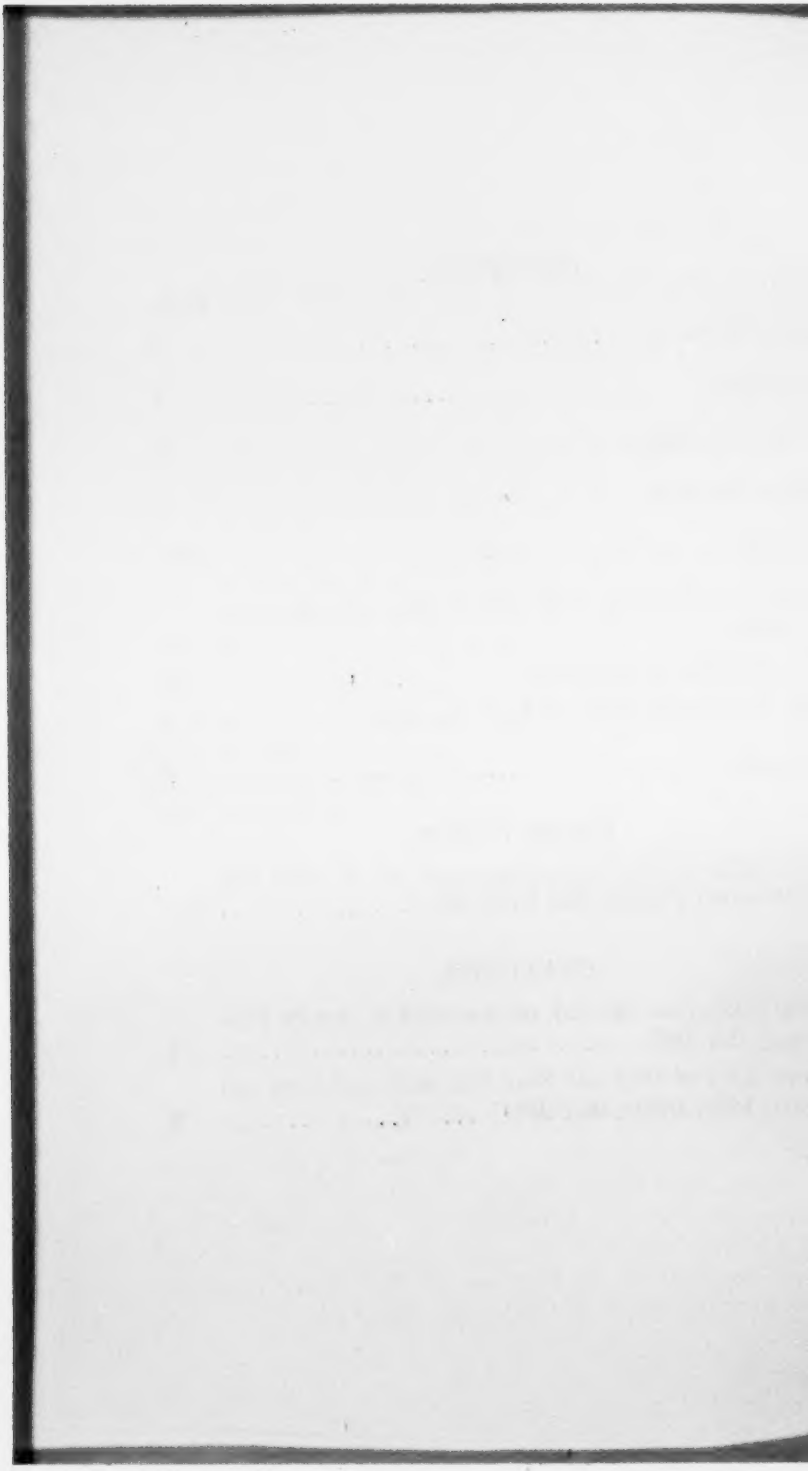
	Page
Opinion Below	1
Jurisdiction	2
Question Presented	2
Statutes Involved	2
Statement	2-4
Reasons for Granting Writ and Petitioner's Supporting Brief	4-5
I. Conflict of Decisions	4-5
II. Important Federal Law Question	5
Conclusions	5

CASES CITED.

Bonwit Teller & Co. v. Commissioner, 53 F. (2d) 381, Certiorari Denied, 284 U. S. 690	2, 4

STATUTES.

Judicial Code, Sec. 240 (a), as amended by Act of February 13, 1925	2
Revenue Acts of 1934 (48 Stat. 680, 689) and 1936 (49 Stat. 1648, 1660), Sec. 23(1)	2



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COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

Comes now the Philadelphia Coke Company, by counsel, and prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered in the above case on July 29, 1942, reversing the decision of the United States Board of Tax Appeals.

OPINION BELOW.

The memorandum opinion of the Board of Tax Appeals (R. 20) in favor of the taxpayer is not officially reported, but may be found at ¶11,777-A, C. C. H. Board of Tax Appeals Decisions Service. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 23) is reported at 130 F. (2d) (Adv. Ops.) 87.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on July 29, 1942 (R. 29). The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

This is a Federal income tax case for the years 1934 and 1936 and involves the determination of the correct amounts of deductions for amortization of a gas main, which determination depends upon whether the cost of a leasehold to the lessee is amortizable over "the first period", where the lease is for "three periods", with the right in the lessor to terminate the lease at the end of "the first period". The Board of Tax Appeals held in favor of the taxpayer on the basis of *Bonwit Teller & Co.* v. *Commissioner,* 53 F. (2d) 381 (C. C. A. 2), certiorari denied 284 U. S. 690. The Circuit Court of Appeals for the Third Circuit reversed the Board.

STATUTES INVOLVED.

Section 23(1) of the Revenue Acts of 1934 (48 Stat. 680, 689) and 1936 (49 Stat. 1648, 1660) provides that in computing net income there shall be allowed as a deduction:

> (1) Depreciation. A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

STATEMENT.

The City of Philadelphia for a long period of years owned a plant for the manufacture of gas. Effective January 1, 1928, the City entered into an operating contract with the United Gas Improvement Company, leasing the gas works to United for an unlimited period with the right in the City or United to terminate the contract on December 31, 1937, or at the expiration of any ten-year period thereafter. Ter-

mination by the City was made to depend upon compliance by the City with certain conditions specified in the contract (R. 4-5).

The lease was assigned by United to The Philadelphia Gas Works Company, its wholly-owned subsidiary, with the approval of the City (R. 6).

In January, 1928, the assignee of the lease, The Philadelphia Gas Works Company, entered into a contract with Philadelphia Coke Company, petitioner herein, for the erection of a plant for the conversion of coal into coke, gas and other products, and the sale of the gas to the Gas Company. The contract between the Gas Company and Philadelphia Coke Company was for a stated period of 30 years. Its termination in the meantime, however, was dependent upon the termination of the contract between the City of Philadelphia and the Gas Company as assignee of United, that is, if the City should terminate its contract with the Gas Company at *the end of any one of the ten-year periods,* the contract between the Gas Company and Philadelphia Coke Company would automatically come to an end. The contract was also subject to the provision that the Gas Company's continuing to accept gas beyond December 31, 1937 (ten years from the date of the contract), was subject to any required approval of such continuance by the City Council of Philadelphia or any other public authority having jurisdiction in the premises (R. 6-7).

In January, 1929, a supplemental agreement was entered into between the Gas Company and Philadelphia Coke Company, whereby the latter contracted to and did erect a 20″ gas main, according to certain specifications, from the latter's plant to the plant of the Gas Company. The cost of this main was $692,985.27. The supplemental agreement provided that immediately upon completion of the main and acceptance by the Gas Company, title thereto should vest immediately in the Gas Company and that Philadelphia Coke Company should have no right, title or interest therein (R. 7, 8, 15).

The gas main was completed and put into service January 1, 1930. Thus the issue is: Should the cost of this gas main be amortized by the taxpayer over the period January 1, 1930, to December 31, 1937, when the lease could be terminated by the City or by the Gas Company, or should it be amortized over the period January 1, 1930, to December 31, 1957, as claimed by the Commissioner?

REASONS FOR GRANTING WRIT AND PETITIONER'S SUPPORTING BRIEF.

I.

Conflict of Decisions.

The opinion of the Circuit Court of Appeals for the Third Circuit is in conflict with the opinion of the United States Circuit Court of Appeals for the Second Circuit in *Bonwit Teller & Co.*, 53 F. (2d) 381, in which the Court held that where the lessee had a lease for years (nineteen years), containing an option giving the *lessee* the right to renew for an additional term of years (twenty-one years), the cost of the leasehold was to be amortized over the original term (nineteen years) rather than over the original term plus the renewal period (forty years altogether). In the present case, the lessee had a lease for thirty years with the right in the *lessor* to terminate the lease in ten years, that is, a vested right for only ten years.

If a taxpayer who has a term lease of nineteen years with the absolute right to extend the lease twenty-one years, a certainty of forty years, is entitled to amortize the lease over "the first period", as was held in the *Bonwit Teller* case, the taxpayer herein, with a lease for thirty years, with the absolute right in the *lessor* to terminate the lease at the end of ten years (thus giving the taxpayer no vested interest whatever beyond the first ten years), should be entitled to amortize the cost over "the first period." As was said by the Board in its opinion in the instant case (R. 21):

"The petitioner's contention is supported by the authorities and must be sustained. In 1934 and 1936 there was no knowing whether the duration of the Gas Company's contract would end December 31, 1937, by the exercise of the City's right to terminate, or would carry on. The petitioner's only assurance was that its supply contract would carry on through 1937. The knowledge and the uncertainty of the taxable years are the governing factors of depreciation deductions of these years, *1620 Broadway Corporation,* 36 B. T. A. 149, and not the later occurrences or possibilities, *Bonwit Teller & Co.* v. *Commissioner,* 53 Fed. (2d) 381, cer-denied 284 U. S. 690."

II

Important Federal Law Question.

The point decided by the United States Circuit Court of Appeals for the Third Circuit involves an important question of Federal law in that, with excess profits taxes running as high as 90 per cent, it is important for lessees to know the exact year in which deductions are to be allowed. Many lessees would be irreparably injured should they be misled as to how to amortize the cost of leaseholds.

CONCLUSION.

WHEREFORE, it is respectfully prayed that this petition be granted.

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Argument	7
Conclusion	9

CITATIONS

Case:

Bonwit Teller & Co. v. *Commissioner*, 53F. (2d) 381, certiorari denied, 284 U. S. 690 — 7, 8

Statutes:

Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 23 — 2

Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 23 — 2

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 502

PHILADELPHIA COKE COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–21) is not reported. The opinion of the Circuit Court of Appeals (R. 23–29) is reported in 130 F. (2d) 87.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 29, 1942 (R. 29). The petition for a writ of certiorari was filed October 29, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Under a contract to supply gas to the assignee of a lease of a municipally owned gas works, petitioner built a gas main through which a part of the gas was to be supplied. Under the contract title to the main vested in the assignee of the lease. Under Section 23 (l) of the Revenue Acts of 1934 and 1936, should the cost of the main be amortized on the basis of the stated term of the contract or on the basis of a shorter period, measured by the earliest date as of which the lease of the gas works could be terminated, the stated life of the contract being dependent upon the nontermination of the lease during that stated term?

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

The provisions of Section 23 (l) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical with those set out above.

STATEMENT

The City of Philadelphia owned a plant for the manufacture of gas which, in 1897, it leased to The United Gas Improvement Company (hereinafter referred to as "United") for a 30-year term ending December 31, 1927. During the term of that lease United operated the plant and facilities, supplying gas to consumers in Philadelphia and its suburbs. (R. 4.)

In 1926 the city and United entered into a new agreement whereby the plant was again leased to United for an indefinite period beginning January 1, 1928, with the right in the city to terminate the lease on December 31, 1937, or at the expiration of any 10-year period thereafter, upon giving certain notice and reimbursing United for expenditures made for improvements and additions to the gas works. United also had the right to terminate the lease on December 31, 1937, or at the expiration of any 10-year period thereafter upon giving due notice. (R. 4–6.)

In December 1927, United assigned the lease to The Philadelphia Gas Works Company (hereinafter referred to as "Gas Company"), its wholly owned subsidiary, with the approval of the city (R. 6).

In January 1928, petitioner contracted with the Gas Company to erect a plant for the conversion of coal into gas and to sell the gas to the Gas Company. This contract, which was approved by the

city, was for a stated term of 30 years, subject, however, to earlier termination if the contract between the city and the Gas Company, as assignee, were terminated. In January 1929, in a supplemental agreement with the Gas Company, petitioner agreed to construct a gas main from its plant to one of the plants of the Gas Company, title to the main to vest in the Gas Company. This gas main was completed and put into service on or about January 1, 1930, at a cost to petitioner of $692,985.27. (R. 6–8, 14–16.)

On March 13, 1936, the Mayor of Philadelphia, pursuant to a city ordinance, notified United and the Gas Company of the city's intention to terminate the leasing agreement as of December 31, 1937. On April 7, 1936, the Gas Company notified petitioner that because of the Mayor's notice the agreement between them would also terminate as of December 31, 1937. However, on December 29, 1937, the city council passed over the Mayor's veto an ordinance directing that the city make a new lease with the Gas Company for a term beginning January 1, 1938. The ordinance also directed that the new lease embody an agreement that the existing lease be terminated as of December 31, 1937, and a provision that the contract between the Gas Company and petitioner should not be extended beyond December 31, 1937. On December 30, 1937, the Mayor threatened to take possession of and operate the gas works. To

forestall that action the Gas Company on the following day instituted a suit to enjoin the Mayor and the city from terminating the 1926 lease, and a restraining order was obtained *pendente lite.* (R. 8–9.)

On December 30, 1937, petitioner entered into a temporary agreement with the Gas Company to continue to furnish gas for the six-months' period ending July 1, 1938. This agreement was extended for 15 days on July 1, 1938. (R. 9.)

On June 30, 1938, the Supreme Court of Pennsylvania rendered a final decision (331 Pa. 321, 1 Atl. 2d 156) enjoining the Mayor and the city from interfering with the Gas Company's peaceful possession of the gas works. The principal ground of the decision was that, although the 1926 lease agreement could have been terminated by the city on December 31, 1937, upon compliance with the conditions of the agreement, the termination had not been effected because of the failure of the city to reimburse the Gas Company for expenditures made for improvements and additions to the gas works. (R. 9–10.) [1]

Following that decision, the temporary agreement between the Gas Company and petitioner was cancelled, and a retroactive agreement dated July 15, 1938, was substituted, covering the period January 1, 1938 to January 15, 1939 (R. 11).

[1] The court held (R. 10): "That such payment not having been made the lease was not terminated and is still in force."

On October 5, 1938, the city council entered into an agreement with the Gas Company which provided that the 1926 lease should be terminated as of December 31, 1937; that the contract between the Gas Company and petitioner should not be extended beyond December 31, 1937; and that with the approval of the city the Gas Company should have the right to purchase gas from other parties, in substitution for or to supplement gas which would otherwise be produced at the gas works (R. 11).

Thereafter, several additional agreements were entered into between petitioner and the Gas Company, extending the agreement of July 15, 1938, to March 31, 1940. Then, by an agreement dated April 1, 1940, the Gas Company contracted for the supply of gas by petitioner for a period of five years from April 1, 1940, and thereafter from year to year unless and until terminated. That agreement was approved by a city ordinance dated April 16, 1940. (R. 11–12.)

In its income tax returns for 1934 and 1936, petitioner claimed as deductions a proportionate part (approximately $\frac{1}{28}$th) of the cost of the gas main, on the ground that the cost should be amortized over the period from January 1, 1930, to December 31, 1957. The Commissioner allowed those deductions. However, during the course of the negotiations leading to the agreement between petitioner and the Gas Company

on April 1, 1940, petitioner prepared claims for refund for 1934 and 1936 on the ground that its property right in the original contract with the Gas Company was terminable at the end of eight years and that the cost of the gas main should, therefore, be amortized over the eight-year period. These claims for refund were filed on March 11, 1938, and March 14, 1940, respectively. (R. 12–13.)

The Board of Tax Appeals held (R. 20–21) that the cost of the gas main should be amortized over the period ending December 31, 1937, the earliest date as of which the city could terminate the 1926 lease. The court below reversed the Board (R. 23–29), holding that the depreciation claimed in petitioner's returns and allowed by the Commissioner for 1934 and 1936 for the amortization of the cost of the gas main over the term stated in the 1928 contract between petitioner and the Gas Company was correct.

ARGUMENT

Although petitioner urges that the decision below conflicts with *Bonwit Teller & Co.* v. *Commissioner,* 53 F. (2d) 381 (C. C. A. 2), certiorari denied on another issue, 284 U. S. 690, the two decisions are in complete accord, as the opinion below itself evidences.

The *Bonwit Teller* case was in substance the converse of the instant case, in that there the property to be depreciated was a leasehold for a fixed term subject to renewal at a rental to be then

determined, whereas here the property to be depreciated is the right to use a gas main for thirty years subject to a possibility of earlier cancellation. In each case there is a fixed period of use, subject to alteration in the event a contingency occurs. In each case the decision was that the property is to be depreciated over the fixed period and the possible alteration of that period by the happening of the contingent event is to be ignored. The decisions are thus wholly consistent.

Petitioner's contention to the contrary is based on a theory which would treat a lease for ten years subject to a right of renewal for ten years, as being the same thing as a lease for twenty years subject to cancellation at the end of ten years. It seems manifest that the two leases are not the same at all, since wholly different results will obtain under the two leases if (1) the contingency in each lease fails to occur or (2) the contingency in both leases occurs. Petitioner's theory is sound only if we assume that in one case but not the other the contingency will occur. There is no basis for such an assumption. As both the instant case and the *Bonwit Teller* case refuse to assume that the contingencies will occur, they are consistent and both are contrary to petitioner's position.

CONCLUSION

The decision below is correct and there is no conflict. The petition should be denied.

Respectfully submitted.

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